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SUBJECT: DOMINICAN REPUBLIC: 2004 INVESTMENT CLIMATE MID
YEAR UPDATE

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¶1. This cable provides the 2004 Investment Climate Mid Year Update for the Dominican Republic tasked reftel

¶2. (begin text)

CHAPTER 7: Investment Climate

Investment Climate

The following is the (preliminary) 2005 Investment Climate Report for the Dominican Republic.(as of July 2004)

A.1. Openness to foreign investment

The Dominican government welcomes foreign investment. However, some laws exist that apply to specific sectors of the economy (e.g., insurance) that may discriminate between domestic and foreign investments. Regulations implementing the 1995 foreign investment law were enacted in September ¶1996.

Under the Foreign Investment Law (No. 16-95), unlimited foreign investment is permitted in all sectors, with the exception of the disposal and storage of toxic, hazardous or radioactive waste not produced in the country; activities negatively impacting public health and the environment of the country; and production of materials and equipment directly linked to national security without authorization from the president. There are no limits on foreign control, or screening of foreign investment in the open sectors. Foreign investors have fully participated at every stage in the capitalization of state enterprises such as the electric company, airport management and sugar mills. In 1997, the government also established the Office for Investment Promotion (OPI), which has proven to be an important contact for potential investors.

In 2003, foreign direct investment in the Dominican Republic was $607 million dollars less than in 2002, according to preliminary data available from the Central Bank. United States investment shrank to $214.8 million dollars, according to the same preliminary data.

A.2. Conversion and Transfer Policies

The Dominican exchange system is divided between the private sector, controlled by commercial banks and exchange houses, and the public sector, operated by the Central Bank. A private sector exchange rate system exists for most commercial bank transactions. The Central Bank uses the average of the market-determined rate of exchange to set its own rate for operations, such as selling foreign currency to the government to pay foreign debt or purchasing currency from those economic entities required to exchange their currency. In addition, the Central Bank purchases foreign currency from the market. Importers may obtain hard currency directly from commercial banks and exchange houses, as well as from the Central Bank. Foreign currency generated from international credit card companies, international telephone traffic, public sector loan payments, and the sale of oil to foreign flagged carriers must be exchanged at the Central Bank.

A.3. Expropriation and Compensation

Dominican expropriation standards have historically been at variance with international norms. A number of U.S. investors have outstanding disputes with the Dominican government concerning expropriated land. Property claims make up the majority of expropriation cases. Most, but not all seizures have been for purposes of infrastructure, or commercial development. In some cases, claims have existed for many years. Investors and lenders often do not receive prompt or adequate payment for their losses, and payment has been difficult to obtain even when a Dominican court has ordered compensation or the government has recognized a claim.

The most recent Dominican governments have expropriated fewer properties than their predecessors and have generally paid

compensation in those cases. A law passed in 1999 authorized the issuance of bonds to settle claims against the Dominican government that arose prior to August 16, 1996, including claims for expropriated property. The Mejia administration is working with a USAID-sponsored expert to resolve outstanding claims. The United States Government is presently aware of 13 claims of US persons that may be outstanding against the Dominican government, down from 22 claims a year ago.

The GODR has not entirely resolved arrears owed to several independent power producers (IPPs) in connection with the partial privatization of the energy sector and faces additional difficulty meeting payment obligations in the short term. This has contributed to cash flow and credit problems for the IPPs and widespread sporadic blackouts. While the GODR has made some partial payments, significant arrears remain outstanding and are a cause of ongoing concern. The 2002 "Madrid Agreement" between the government and most IPPS stipulated that participating IPPs would lower electricity tariffs, if the government made a large one-time payment. The government has not been able to secure financing to put this change into effect.

A.4. Dispute Settlement

The Dominican Republic is a civil law country. A number of U.S. investors, ranging from large firms to private individuals, have payment-related, expropriation, or contractual disputes with the Dominican government and its government-owned enterprises. Both free trade zone and non-free trade zone companies face dispute resolution problems. U.S. firms, obliged to respect the U.S. Foreign Corrupt Practices Act, have had particular difficulty accessing justice within the Dominican system and defending their interests in court. Recent judicial reforms have somewhat improved the administration of justice in the country, but judicial procedures are of uneven quality. In mid-2003, the Senate passed a law creating a special, independent, anti-corruption prosecutor with national jurisdiction. Also in 2003, the government passed a law reforming the process for hiring prosecutors and making them less susceptible to political influence. In 2002, the government passed a new penal process code that defines legal judicial procedures and makes them more transparent. Nevertheless, the judicial system is often unable to enforce decisions in favor of foreign investors.

In April 2002, the Dominican Republic became a member of the International Center for the Settlement of Investment Disputes ("ICSID," also known as the "Washington Convention"). In August 2002, the Dominican Republic ratified the 1958 New York Convention on Arbitral Awards, thereby recognizing the right of companies to pursue international arbitration. The Embassy estimates the total value of U.S. investor claims as at least US $500 million, much of which is owed to energy sector companies.

A.5. Performance Requirements/Incentives

There are no special investment incentives or other types of favored treatment given to foreign investors, nor are there requirements for investors to export a certain percentage of their production. Foreign companies are unrestricted in their access to foreign exchange. Law 69 requires local sourcing when components are of approximately equal cost and quality compared to imports, but this law has not appeared to hinder investors. In addition, there are no requirements that foreign equity be reduced over time or that technology be transferred according to certain terms. The government imposes no location, local ownership, local content, or export requirements or conditions on foreign investors. The Dominican labor code establishes that 80 percent of the labor force of a foreign company, including free trade zone companies, be composed of Dominican nationals (although the management or administrative staff of a foreign company is exempt from this regulation). The Foreign Investment Law provides that licensing contracts for the use of patents or trademarks, the leasing of machinery and equipment, and the provision of technical know-how must be registered with the Central Bank's Directorate of Foreign Investment.

A.6. Right to Private Ownership and Establishment

The Dominican Constitution guarantees the freedom to own private property and to establish businesses. The Foreign Investment Law grants foreign investors the same rights as domestic investors. Public enterprises are not given preference over private enterprises.

A.7. Property Rights

Secured interests in both movable and real property are recognized and generally respected. Mortgages on real property must be registered in the Registry of Titles where the property is located. Real property rights registered under the Dominican Republic's Torrens system of real property registration are binding on third parties.

Provision in the law is also made for registration of liens on personal property. Some United States citizens have reported problems with fraudulent deeds or claims against their properties and difficulties enforcing property rights.

Protection of intellectual property rights has improved in recent years, but is notably deficient in some areas. In 2003, the Office of the U.S. Trade Representative changed the Dominican Republic's status from "Section 301 Priority Watch List," (where it had been from 1998 through 2002), to "Section 301 Watch List." Pirated software, video and audio recordings, as well as unauthorized broadcast and distribution of copyrighted material remain concerns despite increased government efforts to crack down on these violations. In March 2003, the GODR made regulatory changes to the patent law that appears to bring the law into compliance with TRIPS.

A.8. Transparency of the Regulatory System

During the last few years, the Dominican government has carried out a major reform effort aimed at improving the transparency and effectiveness of laws affecting competition.

On November 20, 2002, Congress passed the Financial Monetary Law (Law 183-02) to regulate banks and other key players in the financial sector. The 2003 IMF standby agreement, which is not currently in effect, requires additional regulation and supervision of the banking sector. The primary sections of the Market Regulation Code have all been approved, including legislation in critical areas of the patent and trademark law, telecommunications, copyright, and trade practices and safeguards. The lone exception is in the area of consumer protection. As in many developing countries, however, red tape and differences between law and actual practice are problems. Enforcement efforts are sporadic.

A.9. Efficient Capital Markets and Portfolio Investment

Despite strong GDP growth and largely successful reform efforts that, until 2003, combined to produce a relatively healthy financial sector, Dominican authorities failed to detect years of large-scale fraud and mismanagement at Baninter, the country,s third largest bank. Failure of Baninter and two other banks cost the GODR in excess of $3 billion dollars, severely destabilized the country,s finances and shook business confidence. Inflation in nominal terms was approximately 30 percent over the first six months of 2004 and is likely to reach 40 percent for 2004.

The Dominican stock market, the Bolsa de Valores de Santo Domingo, was founded in 1991. Since beginning operations, the Bolsa has handled initial offerings of commercial paper. The private sector has access to a variety of credit instruments. Foreign investors are able to obtain credit on the local market, but tend to prefer less expensive offshore sources. There are 14 multi-service banks, 15 development banks, 18 savings and loan associations, 1 mortgage bank, 69 finance companies, 23 loan houses, and 1 national housing bank. Portfolio investment grew 370.5 percent in 2003 - an increase largely explained by the issuance of Central Bank certificates to compensate depositors in failed banks. Other CentralBank certificates have been placed with financial entities and individuals at high interest rates to reduce the monetary base. Fixed assets grew 11.4 percent, while other assets -- such as confiscated assets, deferred credits, deferred taxes, and anticipated payments -- increased 51.5 percent.

A.10. Political Violence

There have been sporadic outbreaks of protest in some of the poorer areas of the Dominican Republic over spiraling electricity costs and lengthy rolling blackouts. The murder of PRD Senator Dario Gomez in 2001, a chief architect of the Dominican legislation against money laundering, has not been resolved. Occasional labor protests are generally peaceful. In November 2003 and January 2004 a coalition of organizations sponsored successful national work stoppages in protest to economic conditions.

A.11 Corruption

Corruption remains a pervasive problem in government and within law enforcement agencies nationwide. Corruption and the need for reform efforts are openly and widely discussed.

¶B. Bilateral Investment Agreements and Tax Agreements

In March 2004, the Dominican Republic completed negotiating a comprehensive free trade agreement with the United States, which will associate the country with the Central American Free Trade Agreement (CAFTA). As of July 1, 2004, the agreement had not been signed. The Dominican Republic has a

Bilateral Investment Treaty with Spain and numerous bilateral trade agreements with Central American countries, but these do not provide the level of protection to investors generally offered by U.S. bilateral investment treaties. An Agreement for the Exchange of Tax Information between the United States and Dominican Republic has been in effect since 1989.

¶C. OPIC and other Investment Insurance Programs

The Overseas Private Investment Corporation has been active in the Dominican Republic with both insurance and loan programs. The Dominican government is a party to the Multilateral Investment Guarantee Agency (MIGA) Agreement.

¶D. Labor

The Dominican Constitution provides for the right of workers to strike (and for private sector employers to lock out workers). The Dominican Labor Code, which became law in June 1992, is a comprehensive piece of legislation which establishes policies and procedures for many aspects of employer/employee relationships, ranging from minimum wage levels, hours of work, overtime and vacation pay, to severance pay, causes for termination, and union registration. The labor code also requires that 80 percent of non-management workers of a company be Dominican nationals. The standard workweek is 44 hours. Most jobs pay salaries based on the minimum wage. Some labor shortages exist in professions requiring lengthy education or technical certification.

An ample labor supply is available, although there is a scarcity of skilled workers and technical supervisors. Most employers have found the local work force competent, trainable, and cooperative. Foreign employers are not singled out when labor complaints are made. About 10 percent of the nation's work force is unionized. The labor code specifies that 20 percent or more workers in a company may form a union. Before a union may enter into a collective bargaining agreement or officially call a strike, however, it must have the support of an absolute majority of all company workers, whether unionized or not; have previously attempted to resolve the conflict through mediation; provided written notification to the Ministry of Labor of the intent to strike; and waited 10 days from that notification before striking. Due to these stringent requirements, brief work stoppages are more common than lengthy strikes. For example, early in 2003, members of several major transportation unions briefly walked off the job to protest the rising cost of fuel. Collective bargaining is legal and may take place in firms in which a union has gained the support of an absolute majority of the workers. Very few companies have collective bargaining pacts. The Dominican labor code stipulates that workers cannot be dismissed because of trade union membership or union activities; however, in practice, it appears workers are sometimes fired because of union activities. The Dominican labor code establishes a system of labor courts for dealing with disputes. While cases do make their way through the labor courts, enforcement of judgments is not 100 percent reliable.

Many of the major manufacturers in the free trade zones (FTZs) have voluntary "codes of conduct" that include workers, rights protection clauses, but it is not clear whether these incorporate the ILO,s Fundamental Principles and Rights at Work. In general, workers are rarely familiar with such codes or the principles they set out, and no independent monitoring system exists to ensure that these codes are respected.

¶E. Foreign Trade Zones/Free Ports

The Dominican Republic's free trade zones (FTZs) are regulated by Law 8-90, which provides for 100 percent exemption from all taxes, duties, charges and fees affecting production and export activities in the zones. These incentives are for 25 years for zones located near the Dominican-Haitian border, and 15 years for those located throughout the rest of the country. This legislation is managed by the Free Trade Zone National Council (CNZF), a joint private sector/government body which, among its other powers, has discretionary authority to extend the time limits on these incentives.

Hard currency flows from the free trade zones are handled via the free foreign exchange market. Foreign and Dominican firms are afforded the same investment opportunities both by law and in practice. The CNZF's Annual Statistical Report for 2002 noted a Free Zone Sector with a total of 53 free zone parks and 520 operating companies. Of those companies, 254, or 49 percent are from the United States. The total cumulative investment in Free Trade Zones is approximately US$ 1.3 billion at year-end 2003, of which nearly 74 percent represents foreign investment. Over 61.3 percent of foreign investment came from the U.S., followed by companies registered in Korea, Netherlands, and Switzerland. In

general, firms operating in the free trade zones experience far fewer bureaucratic and legal problems than do firms operating outside the zones.

Exporters/investors seeking further information from the CNZF may contact:

Consejo Nacional de Zonas Francas
Leopoldo Navarro No. 61
Edif. San Rafael, piso no. 5
Santo Domingo, D.R.
Phone: (809) 686-8077
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Web-site Address: www.cnzfe.gov.do

¶F. Foreign Direct Investment Statistics

Foreign direct investment in the last few years has been largely concentrated in tourism, free trade zone activity, electricity generation and communications. The Dominican government has made a concerted effort to attract new investment, taking advantage of the new foreign investment law and of the country's natural and human resources. The decision to privatize or "capitalize" ailing state enterprises (electricity, airport management, sugar) has attracted substantial foreign capital to these sectors.

Foreign Investment Data (US$ millions)
Central Bank of the Dominican Republic
2003 Numbers
FDI Stocks 7520.4
FDI Stock /GDP 45.0%
FDI Flows 310.0
* Preliminary data from the Central Bank

FDI flows by source country
YEAR 2003* (in millions)
United States 214.8
Canada 170.0
Spain -300.8
UK -0.2
France 51.5
Netherlands 70.0
Italy 15.2
Bahamas 8.9
Colombia 32.6
Others 48
Total 310.0
* Preliminary Data for 2003, from the Central Bank of the Dominican Republic

FDI by Sector
2003*
Tourism 163.2
Trade 12.4
Communications 184.9
Electricity -241.5
Finance 86.3
Free Zones 56.1
Others 48.5
Total 310.0

Major Foreign Investors:

Following are some of the largest companies registered as foreign businesses by the Central Bank of the Dominican Republic:

¶1. Compania Dominicana de Telefonos (CODETEL) owned by Verizon (U.S.): the main telephone service provider, which has operated in the Dominican Republic for more than 70 years. In 2004 the firm changed its name in the Dominican Republic to Verizon,

¶2. Central Romana Corporation (U.S.): A diversified operation that includes a hotel, sugar plantations, a mill and real estate businesses, among other activities.

¶3. E. Leon Jimenes, C. por A. (a local partner of Phillip Morris, of the U.S.): this company produces cigarettes, cigars and beer.

¶4. Falconbridge Dominicana (Canada): produces ferro nickel for mining export in the Dominican Republic.

¶5. Shell Company (Netherlands/England): shares ownership with the Dominican government of the only petroleum refinery in the country (50% each) and is a distributor of petroleum by-products.

¶6. Citibank (U.S.): the bank has operated in the Dominican Republic for many years.

¶7. Esso Standard Oil (U.S.): Esso is a long-time distributor of petroleum by-products.

¶8. Texaco Caribbean (U.S.): Another long-time distributor of petroleum by-products.

¶9. Colgate Palmolive, Inc. (U.S.): a leading manufacturer in the Dominican Republic of soaps and toothpaste.

¶10. Bank of Nova Scotia (Canada): One of the oldest foreign commercial banks in the Dominican Republic. Known as Scotiabank.

¶11. AES (U.S.): Through local subsidiaries, AES operates the electricity distribution network in the eastern half of the country, as well as electricity generation plants.

¶12. Prisma Energy (U.S.): In partnership with other companies, operates an electricity generating plant Puerto Plata.

¶13. Coastal (U.S.): A major investor in electricity generation.

¶14. Seaboard (U.S.): A major investor in electricity generation.

¶15. Tricom (40% owned by Motorola - U.S.): Second largest provider of long distance and cellular telephone services in the Dominican Republic.

¶16. Cogentrix (U.S.) An independent power producer with 300 MW capacity.

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